

CONFIDENTIAL
Central Intelligence Agency



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

1 September 1983

The Chinese Economy

25X1

The Chinese economy is in much better shape than it was just a few years ago. Personal incomes and consumption are up substantially; agricultural output has grown remarkably; and foreign trade has expanded. The new Sixth Five-Year Plan (1981-85) provides a reasonably well-defined policy framework for the first time since the 1950s.

In several respects, however, economic progress has proved elusive. The appalling waste and inefficiency that characterized the Chinese economy in the 1970s--particularly its manufacturing sector--remains equally serious today.

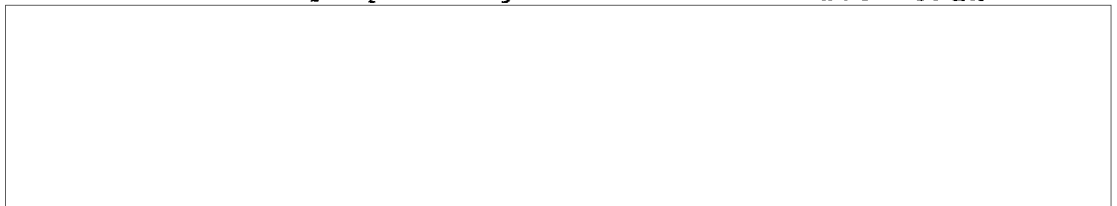
- Labor productivity has essentially stagnated.*
- Production costs have continued to rise.*
- And the use of energy and raw materials remains excessive.*

Paradoxically, management reforms that have strengthened the profit motive and decentralized financial decision making--reforms aimed at reducing waste--have also made it more difficult for the Chinese to complete urgently needed projects in the bottleneck sectors of energy and transportation. This failure to meet completion targets for critical energy and transport projects is at the center of policy discussions in Beijing. Only slightly less important is how to ensure further improvements in living standards and consumption in the face of large investment requirements.

China's inability to complete critical energy and transportation projects on schedule is closely related to the

25X1

This memorandum was prepared by the Office of East Asian Analysis



CONFIDENTIAL

investment surge that followed a decision to allow enterprises to retain a portion of their profits. Last year, the investment plan called for a nominal increase in capital construction but by the end of the year actual spending was up by over 25 percent. Almost half of the increase came from unplanned spending by enterprises, financed from retained profits. This investment stretched existing supplies of scarce building materials, forcing more delays in construction work on energy and transportation facilities.

Performance in 1982

China's economic performance in 1982 was fairly typical of recent years.

- GNP and industrial production each rose by over 7 percent.
- Energy production rose by 5.7 percent, easing what still is the major constraint on growth.
- Agricultural output, benefiting from favorable weather and a continuation of liberal policies, grew by a remarkable 11 percent.
- Personal incomes in rural areas grew by perhaps 8 to 9 percent in real terms, while urban incomes grew by only 2 to 3 percent in real terms.
- Urban unemployment may have reached toward 10 percent.
- Inflation ran between 5 and 10 percent.

Beijing still had problems providing adequate supplies of consumer goods. Excessive growth in heavy industry--9.9 percent instead of a planned 1 percent--diverted energy, transportation and other inputs away from consumer goods production and held light industrial growth to 5.7 percent, the lowest rate in recent years. Also, as incomes have grown, Chinese consumers have become increasingly selective in their purchases. In the absence of high-quality, stylish goods, they continued to deposit large sums of money in savings accounts; and inventories of rejected merchandise continued to pile up.

Typically--and this has been a continuing source of disappointment for the Chinese leadership--1982 saw no significant reduction in the wasteful use of resources.

- Industrial costs declined only marginally.
- More energy and raw materials were used per unit of output.
- Quality, too, remained a serious problem.

At the end of 1982, China was in its strongest international financial position ever. Foreign exchange reserves stood at over \$11 billion, more than double the 1981 total. Those reserves now have surpassed the United Kingdom's, and amount to the seventh largest in the world. Most of the increase in reserves, however, came as a result of cuts in imports, which fell by 10 percent. With exports growing by over 3 percent, the trade surplus reached \$6.3 billion.

In Sino-US trade, a 21-percent increase in exports combined with a 19-percent decline in imports reduced China's trade deficit from \$1.7 billion in 1981 to \$0.6 billion last year. On the export side, Chinese sales of textiles and clothing rose by 34 percent; sales of petroleum and petroleum products grew by 104 percent. On the import side, grain purchases continued to rise, by almost 5 percent on a volume basis; purchases of textile fibers, however, declined by more than 60 percent. The decline in imports of textile fibers seems to have been unrelated to the Sino-US textile dispute, but was the result of excessive fiber inventories.

The first half of 1983 has seen a continuation of some of the more unwelcome developments of 1982. Investment spending has continued to grow at a 20-percent pace. Coming on the heels of last year's 25 percent growth, this has frightened Beijing into action. The construction program is being given a thorough review where possible, lower priority projects are being halted or dropped entirely, and new, tougher regulations pertaining to project review and approval have been issued.

Too-rapid growth in heavy industry continues to squeeze consumer goods production. During the first six months of this year, heavy industrial output rose by 12.2 percent over the year-earlier period. The annual target is 3.9 percent. Light industry grew by 5.4 percent, higher than the 4.1 percent annual target but still modest compared with recent years.

Management Reforms

Since the late 1970s, China has experimented with management reforms in practically every sector of the economy. The basic thrust has been to decentralize decisionmaking in an attempt to boost production and efficiency. Agriculture reforms, which have focused on reducing the government's role in production and marketing decisions, have been most successful. Most of these decisions apparently are now made by farm households or even individual farmers, a development which we believe has been a very important element in the agricultural growth since the late 1970s. But--and this is the major complication--Beijing has also raised prices for agricultural products, itself a considerable stimulus.

In industry, the reforms have involved a strengthening of the profit motive and allowing enterprises to retain a portion of

CONFIDENTIAL

their profits--rather than being forced to remit profits in their entirety to the government, as had been the case. But because of major irrationalities in China's price system, the changes have not produced the desired effects. The reforms have provided the funds for enterprises to carry out additional investment, and the result has been an overextended construction program as mentioned earlier.

Reforms in other sectors include:

- Allocating a larger proportion of fixed and working capital through the banking system, at interest rates that better approximate the value of capital services.
- Encouraging more direct contact between producing enterprises and their customers, both retail agents and final consumers.
- Allowing enterprises and individuals to sell above-plan output to other enterprises or individuals at a "negotiated" price, in effect a price that is higher than the state price but one that is not as high as the market will bear.

25X1

CONFIDENTIAL